The Endowment Ebbs

The University’s endowment was valued at $35.7 billion last June 30, the end of fiscal year 2016—a decrease of $1.9 billion (5.1 percent) from a year earlier. The fiscal 2016 depreciation reflects a negative 2.0 percent investment return, and the effects of distributing $1.7 billion for Harvard’s operating budget, offset somewhat by gifts received as a result of the Harvard Campaign (see “$7 Billion, and Counting,” page 21).

The investment losses, announced in a September 22 letter from Robert A. Ettl, who became acting CEO of Harvard Management Company (HMC) last May, are a clear disappointment. While pointing to difficult external conditions (he cited a “low interest rate environment and market volatility”), Ettl also bluntly wrote, “[W]e recognize that execution was also a key factor in this year’s disappointing results.” Indeed, HMC’s aggregate performance trailed its market benchmark by 3.0 percent: a gap of well more than $1 billion. The latest results reduced HMC’s cumulative annualized returns for the past five- and 10-year periods to 5.9 percent and 5.7 percent; during the past year and five- and 10-year periods, a domestic portfolio consisting of 60 percent stocks and 40 percent bonds (essentially, an unmanaged, indexed pool of funds) yielded 5.0 percent, 8.9 percent, and 6.9 percent.

The year was supposed to have begun a crucial transition for HMC, with restructured asset-allocation systems, internal investment processes, new personnel, and strengthened relationships with external money managers—all outlined in 2015 by new HMC president and chief executive Stephen Blyth—setting the stage for stronger investment returns. (His sweeping agenda is detailed at harvardmag.com/hmc-overhaul-15.) He set as goals earning a real return of 5 percentage points above the rate of inflation in higher-education costs (to accommodate annual distributions of about 5 percent of the endowment’s value, while securing its long-term purchasing power); a sustained aggregate performance of at least 1 percentage point above HMC’s market benchmarks; and top-quartile performance compared to 10 university peers (versus Harvard’s bottom-quartile ranking in the four most recent five-year periods).

Instead, measurable progress toward these long-term goals appears to have been disrupted. Blyth himself went on medical leave Commencement week, and relinquished his HMC positions in July. (The University announced his successor, N.P. Narvekar, on September 30. Narvekar has overseen Columbia’s smaller endowment since 2002, and has recently achieved relatively strong long-term returns—in part because its losses during the financial crisis in fiscal 2009 were far less severe than peer institutions’. For details, see harvardmag.com/narvekar-16.)

Although Ettl’s report conveyed a strong sense of continuity with the directions Blyth had outlined, the investment performance was brutal in certain asset classes (see chart), and new challenges emerged.

The domestic equity portfolio, for instance, produced a return of negative 4.9 percent (versus a positive 2.5 percent benchmark return); as Ettl noted, “Unfortunately, a number of our domestic equity external managers underperformed for the first time in many years,” as several of those managers also “held closely correlated portfolios,” particularly in underperforming sectors, “further impacting the performance of the asset class.” Internal performance was such that the management team was downsized in June, with assets being transferred to outside investors. The foreign and emerging-market equity portfolios had returns of negative 14.2 percent and 12.0 percent, respectively (in difficult markets for those sectors); they and other equity portfolios are scheduled to report to a new head of absolute-return and public-markets funds, who is to be hired.

Natural resources has long been an area of significant strength, with successful, pioneering investments in timber and agricultural lands and, in recent years, debt portfolio management to avoid the fallout from plunging oil, natural gas, and commodities prices. No longer: in fiscal 2016, HMC’s assets produced a negative 10.2 percent return, versus positive market performance. A new managing director is on the way, following the retirement of the head of alternative investments last year.

Private-equity, fixed-income, and absolute-return results hovered around benchmark returns. The aggregate result, unfortunately, was to dilute the strong performance of real-estate investments, where HMC’s strategic redirection at the beginning of the decade now appears to be yielding the hoped-for strong returns. (A full report on HMC’s performance and the challenges of improving it, outlined below, appears at harvardmag.com/endowment-drop-16.)

HMC’s results, of course, are not merely of interest to handicappers: the endowment now funds about 35 percent of Harvard’s operating budget—a reality underscored by that $1.7-billion distribution. In the year just reported, investing in the same sectors and market conditions, MIT’s endowment returned a positive 0.8 percent, Yale’s 3.4 percent, and Stanford’s negative 0.4 percent. During the past 10 years, Yale’s annualized return is 8.1 percent. That is 2.4 percentage points higher.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>HMC Return</th>
<th>Benchmark Return</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public equities</td>
<td>(10.2)%</td>
<td>(6.1)%</td>
<td>(4.1)%</td>
</tr>
<tr>
<td>Private equity</td>
<td>2.6%</td>
<td>2.2%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Absolute return</td>
<td>(1.2)%</td>
<td>(0.3)%</td>
<td>(0.9)%</td>
</tr>
<tr>
<td>Natural resources</td>
<td>(10.2)%</td>
<td>1.4%</td>
<td>(11.6)%</td>
</tr>
<tr>
<td>Real estate</td>
<td>13.8%</td>
<td>9.4%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Fixed income</td>
<td>5.5%</td>
<td>6.2%</td>
<td>(0.7)%</td>
</tr>
<tr>
<td><strong>Total endowment</strong></td>
<td><strong>(2.0)%</strong></td>
<td><strong>1.0%</strong></td>
<td><strong>(3.0)%</strong></td>
</tr>
</tbody>
</table>
Matthew Wittmann has three tattoos. Two mostly stay hidden: the giraffe on his shoulder, which marked the 2012 publication of his two books on the American circus, and Paul Klee's *Angelus Novus*, which landed on his arm after he finished his Ph.D. at the University of Michigan in 2010. Most visible is an inky star between his right thumb and forefinger, dating back to college—"a tattoo popular among nineteenth-century whalers," he explains. A cultural historian, Wittmann specializes in traveling entertainments (like "minstrel groups, magicians, and circuses") and the Pacific—interests kindled by a peripatetic navy-brat childhood on the West Coast and in Hawaii. "Having lived so many places when I was young, I don't get hung up on, you know, home," he says; neither does he pile up personal possessions. Now the new curator of the Harvard Theatre Collection at Houghton Library, he's charged with the care and development of the oldest performing-arts library in the country. Recalling his initial reaction to the job description—"Oh, dear"—Wittmann describes his duties as "expansive." That word also applies to Harvard's holdings, which are "so vast that every day, I am finding things that you couldn't believe": a bronze of actress Sarah Bernhardt, given her by Harry Houdini, sits near his desk. The collection has strengths in some areas he's less versed in (notably ballet), but Wittmann is unfazed. When he became an assistant curator at the American Numismatic Society, he wasn't an expert on coins. "It gave me the experience of having to learn wholesale a sort of language and a field and a history that I wasn't that familiar with." In turn, he hopes to bring something new to the archive, expanding its scope to include more pop entertainment. Curtains up for the next act.

Matthew Wittmann

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taps on the brakes, constraining growth in one-third of revenues. But for highly endowment-dependent units—the Radcliffe Institute, Harvard Divinity School, and the Faculty of Arts and Sciences (FAS) all derive more than half their income from those distributions—adjusting may be much more uncomfortable. For units operating at a loss now (on a cash basis), including FAS and its engineering school, and Harvard Medical School, the squeeze is tighter still. And beyond these current impacts, deans will have to lower the trajectory of their long-term financial projections.

The leverage is huge. The University’s financial model assumes it can distribute about 5 percent of the endowment’s value each year. At present, if investment returns reach 10 percent, the annual increase in value enables Harvard to fund the operating distribution and retain an equal sum to support its future academic programs. But in a year like fiscal 2016, when the assets depreciate modestly, and the University makes normal distributions for the budget, the decline in value essentially offsets all gifts for the endowment received during the course of the capital campaign to date ($1.5 billion from fiscal years 2011 through 2015, plus the 2016 sum to be reported this fall); the proceeds realized from six years of concerted private and public fundraising.

Middling returns, like HMC’s 10-year annualized rate of 5.7 percent, condemn the University to treading water—at best. In real terms, the endowment is now worth several billion dollars less than its value before the financial crisis in 2008, and it is being relied upon to support a University budget that is about $1 billion larger. The intersection between that rate of return and the distribution rate means that the endowment’s purchasing power erodes. The nominal principal (not catching up with inflation) would then essentially grow only to the extent that it is augmented by gifts—and relative to a nearly $36 billion corpus, those gifts would have to be large to make a difference. Absent that level of philanthropic largesse year after year, if investment returns failed to sustain both the current distribution percentage and real purchasing power, the Corporation would confront an excruciating choice: running down the value of the endowment—foundational assets, meant to exist in perpetuity; or reducing the distribution rate—thus upending the financial model on which Harvard’s academic operations depend.

So fixing HMC’s performance is critical. How to proceed?

Without question, the organization needs to cultivate stronger relationships with demonstrably superior external asset managers. Blyth and others have acknowledged that, following the financial crisis, those relationships frayed as Harvard had to bolster liquidity: steps that required HMC to reduce commitments to fund future investments it could no longer assuredly pursue, and to limit the size of new commitments no matter how promising the potential opportunity. HMC will also likely want to gain experience with its more flex-

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Paying a $1.4-Billion Repair Bill

An article on “House Renewal Gains and Challenges” in the September-October issue (page 17) reviewed the successes of the College’s renovation of undergraduate residences to date, the schedule for the next renewal projects, and the status of fundraising for the program, which has been estimated to cost $1.4 billion. It also noted inflating Boston-area construction costs, rising 5 percent to 7 percent annually—and raised, but could not fully answer, questions about how the full program could be paid for in a timely way.

Additional information made available after that article went to press was published online (see “House Renewal Update,” available at harvardmag.com/houses-16). These are highlights:

**Decapitalizations.** During fiscal years 2011 through 2015, the Faculty of Arts and Sciences (FAS) drew upon $358 million of appreciated endowment funds for House renewal: $253 million to pay for project costs; and $105 million to pay down existing debt (most of it incurred to build science facilities in the prior decade)—in effect creating room for future House-renewal-related borrowing.

**Income effect.** Subject to several assumptions and variables, those decapitalizations are calculated to reduce FAS’s flow of cash, distributed from the endowment and applicable to its most pressing needs, by about $25 million through the renewal project’s projected conclusion in fiscal 2025. The loss of income course continues thereafter, given the permanent withdrawal of capital from the endowment and forgone appreciation and distributions. (See “The Endowment Ebbs,” page 18, for discussion of the faculty’s reliance on endowment distributions, and the challenges of weak investment performance.)

**Spending.** Through May 31, FAS had spent $391 million on planning and architectural costs; completed reconstruction of Stone Hall, Leverett McKinlock, and Dunster House; preliminary work on Winthrop House, where full construction began just after Commencement; and design and preliminary work on Lowell House, scheduled to ramp up next summer. The funds came from FAS’s decapitalizations, its reserves, and campaign gifts and pledge payments. The pace and scale of spending are now rising rapidly, for the Winthrop and Lowell projects.

Remaining project financing depends on continued robust fundraising, and on some form of borrowing. The details will require the Corporation to determine how much FAS can borrow and on what terms; what part of the program, if any, might be deemed a University priority (as is the case for the new Allston facilities for FAS’s engineering and applied sciences faculty), among other competing aims; and how long Harvard can wait, in light of escalating construction and materials prices, to bring the remaining River Houses up to twenty-first-century standards.}

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KRIS SNIBBE/HPAC

Winthrop House is being renovated and enlarged.
$7 Billion, and Counting

The academic year began, promisingly, with the announcement that The Harvard Campaign—launched publicly in September 2013 with $2.8 billion raised toward a $6.5-billion goal—had secured gifts and pledges totaling “more than $7 billion” as of this past June 30, the end of fiscal year 2016. In nominal terms, not adjusted for inflation, that sum exceeds the previous higher-education record, established when Stanford concluded its campaign in 2011 with $6.2 billion committed. Harvard’s fundraisers remain hard at work, hoping to fulfill remaining priorities—notably, undergraduate House renewal; the 550,000-square-foot engineering and applied sciences facilities in Allston (price tag: $1 billion); financial-aid endowment funds across the University; and the remaining goals at units such as the Graduate School of Design, the Divinity School, and the Medical School. Their attention is being focused by the approaching formal end of the drive, now firmly set for June 30, 2018.

Some tangible fruits of campaign gifts are already evident, most visibly in the construction projects transforming the campus (see “Harvard Loves Hard Hats,” September-October, page 14). The news announcement also highlighted $820 million then raised for financial aid ($460 million of that for undergraduates) and funding for “nearly 90 professorships” across the University, a mixture of existing and new positions.

“I am deeply grateful to everyone who has participated in this outstanding effort so far,” said President Drew Faust in a statement. “Our aspirations speak to our larger hopes not only for a better Harvard, but also for a better world—a world changed by the students we educate, the knowledge we pursue, and the discoveries and innovations we generate every day on our campus. The support we’ve received thus far resounds with confidence in the enduring value of this work and the essential role that Harvard—and all of higher education—plays in society.”

For a detailed report on the campaign, with updates on individual schools’ results, see harvardmag.com/7billion-16.

—J.S.R

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Princeton, MA  McLeanFernside.org |  NEW Camden, ME McLeanBordenCottage.org
John Harvard’s Journal

Yesterday’s News
From the pages of the Harvard Alumni Bulletin and Harvard Magazine

1921 Thirteen female students from the Graduate School of Education apply for tickets to the Yale Game. The Bulletin reports that three ticket clerks “whose temperaments are especially nervous have followed the advice of their physicians by resigning.”

1931 The Corporation decides that Harvard will not participate in a fundraising postseason football game for unemployment relief, to avoid setting a potentially troublesome precedent and further commercializing college football by playing only to raise money. Collections at the Dartmouth, Holy Cross, and Yale games, however, raise more than $20,000 for the same purpose.

1941 Two freshmen enliven hour-exam period with their Crimson classified: “Wanted—Information where one may obtain a human corpse in reasonable condition.” The 42 phone calls in response range from students wishing to be embalmed after hourlies to several funeral directors, the police department, and the morgue. The Yardlings plead simple curiosity as the impetus for the ad.

1961 Among alterations proposed for the Harvard School of Business Administration after a two-year study initiated by its dean is a change of name. The Bulletin reports a “widespread feeling” that the present name “does not imply an institution of professional stature, and that there should be...a Harvard Business School.”

1981 The Harvard-Radcliffe Conservative Club publishes the first issue of The Harvard Salient. Its editors all “commend free enterprise, limited government, a redoubtable national defense, the integrity of community, and the sustaining prescriptions of tradition,” and promise not to practice the incendiary journalism of the year-old Dartmouth Review.

2001 A new plaque installed in Memorial Church honors three Radcliffe alumnae—Lucy Nettie Fletcher ’10, Ruth Holden ’11, and special student Helen Homans—who died in World War I while serving as nurses.

(175 to 250 people during the past decade or so)—and that its leader has significant day-to-day management responsibilities. Many peer endowments like Columbia’s, which rely largely or exclusively on external investment managers, select them and oversee their performance with a small core staff (typically, 20 to 40 people in all). In such systems, the leader of the team is principally a chief investment officer. Transitioning from HMC’s recent performance record toward the ambitious, essential return goals Blyth outlined will take time: many existing assets are invested in illiquid, long-term portfolios, and as assets and future cash flows are redeployed, the hoped-for, improved returns will emerge only gradually (as in the real-estate results cited above). HMC’s new leader already faces a huge performance challenge; meeting it may also require him to make the most basic decisions about what kind of investment operation the University requires to succeed in the twenty-first century.

~John S. Rosenberg

Online-Education Updates

Four years after Harvard and MIT launched edX, their online-course venture, in May 2012, MIT scholars have published “Online Education: A Catalyst for Higher Education Reforms,” a review of the field. Its lead authors—Karen Willcox, professor of aeronautics and astronautics, and Sanjay Sarma, Flowers professor of mechanical engineering and the institute’s vice president for open learning—look beyond the massive open online courses (MOOCs) that attracted such hoopla when edX was conceived. They focus instead on education and learning more broadly, and the implications for campus classrooms.

That emphasis is especially notable for two reasons. First, in the wake of MIT’s broad strategic embrace of new approaches to learning (see “What Modularity Means for MOOCs,” harvardmag.com/mit-edx-16), two-thirds of its undergraduates are reported to have taken courses that incorporate the edX interactive instructional software. Second, underwriting MOOC technology both for free use by self-motivated learners around the world and for its application in classrooms on this residential cam-

Illustration by Mark Steele

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